

AMENDED IN ASSEMBLY MAY 6, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

ASSEMBLY BILL

No. 1622

Introduced by Assembly Member Wyland

February 21, 2003

An act to amend ~~Section 23801~~ *Sections 23803, 23806, and 23809* of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 1622, as amended, Wyland. Bank and corporation tax: ~~S corporation~~ "S corporation".

The Corporation Tax Law provides that, for taxable years beginning on or after January 1, 2002, corporations that have elected to be taxed as "S corporations" for federal tax purposes are deemed to be "S corporations" for California income tax purposes, unless the entity is prohibited from being a California "S corporation." The Corporation Tax Law, in modified conformity to federal income tax laws, provides for the specified tax treatment of "S corporations" and their shareholders. Among other things, that law requires that an election made under federal income tax laws, relating to certain stock purchases treated as asset acquisitions, be treated as an election for state tax purposes, specifies the application of credits to reduce the entity level tax, and imposes a tax on built-in gains attributable to California sources, as provided.

This bill, for taxable years beginning on or after January 1, 2004, would allow an "S corporation," as provided, to carry forward a net operating loss incurred by that corporation as a "C corporation" from its last taxable year beginning before January 1, 2002, to the first

taxable year beginning on or after January 1, 2004, in which the corporation is treated as an “S corporation” for state tax purposes as a result of the enactment of Chapter 35 of the Statutes of 2002. This bill would also allow an “S corporation” to carry forward the full amount of tax credits generated by that corporation as a “C corporation” to the first taxable year beginning on or after January 1, 2003, in which the corporation is deemed to be an “S corporation” for state tax purposes pursuant to Chapter 35 of the Statutes of 2002. This bill would also prohibit utilization of any net operating loss carryover against net built-in gain recognized by the corporation, as provided.

~~The Bank and Corporation Tax Law, in specified conformity to federal income tax law, provides that an election to be treated as an “S corporation” may be made by a small business corporation, as defined, that, among other things, does not have more than 75 shareholders.~~

~~This bill would make technical, nonsubstantive changes to those provisions.~~

Vote: majority. Appropriation: no. Fiscal committee: ~~no~~ yes. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 ~~SECTION 1. Section 23801 of the Revenue and Taxation~~
- 2 ~~SECTION 1. Section 23803 of the Revenue and Taxation Code~~
- 3 ~~is amended to read:~~
- 4 23803. (a) (1) With respect to credits ~~which~~ *that* are
- 5 otherwise allowed to reduce the taxes imposed under this part:
- 6 (A) The amount of any credit to be claimed ~~shall be~~ *is* limited
- 7 to one-third of the amount otherwise allowable.
- 8 (B) (i) Any unused portion of the credit allowable under
- 9 subparagraph (A) (one-third of the total credit) ~~shall be~~ *is* allowed
- 10 to be carried forward and ~~shall~~ *may* not be subject to additional
- 11 reductions under subparagraph (A) in later years.
- 12 (ii) No carryforward ~~shall be~~ *is* allowed for the portion of the
- 13 credit denied under subparagraph (A) (two-thirds of the total
- 14 credit).
- 15 (C) Credits carried forward from taxable years beginning prior
- 16 to the first taxable year in which the corporation is treated as an “S
- 17 corporation” under this part, shall be reduced in accordance with
- 18 subparagraph (A) for that first taxable year and ~~shall~~ *may* not be

1 subject to additional reductions under subparagraph (A) in later
2 years.

3 ~~(D) The provisions of paragraphs (i) Notwithstanding any~~
4 ~~other provision of law, subparagraph (A) of paragraph (1) of this~~
5 ~~subdivision does not apply to credits generated by a corporation~~
6 ~~that is described in clause (ii) of this subparagraph and carried~~
7 ~~forward from the last taxable year beginning before January 1,~~
8 ~~2002, in which that corporation was treated as a “C corporation,”~~
9 ~~to the first taxable year beginning on or after January 1, 2003, in~~
10 ~~which the corporation is treated as an “S corporation” pursuant~~
11 ~~to the enactment of Chapter 35 of the Statutes of 2002. The credits~~
12 ~~that are carried forward from the last taxable year of the “C~~
13 ~~corporation” beginning before January 1, 2002, may not be~~
14 ~~reduced in later years and may be utilized to offset the tax imposed~~
15 ~~under either Section 23151 or Section 23501.~~

16 (ii) This subparagraph applies to a corporation that, for its last
17 taxable year beginning before January 1, 2002, was an “S
18 corporation” for federal income tax purposes and a “C
19 corporation” for purposes of Part 10 (commencing with Section
20 17001), Part 10.2 (commencing with Section 18401), and this
21 part, and, as a result of the enactment of Chapter 35 of the Statutes
22 of 2002, is an “S corporation” for the corporation’s taxable year
23 beginning on or after January 1, 2003.

24 (E) Paragraphs (2) and (3) of subdivision (f) of Section 23802
25 ~~shall be applied~~ apply prior to the reduction required by
26 subparagraph (A).

27 ~~(E)–~~

28 (F) No portion of any credit to which this paragraph applies
29 ~~shall~~ may be passed through to the shareholders of the “S
30 corporation.”

31 ~~(F) The provisions of this~~

32 (G) This paragraph ~~shall~~ does not affect the amount of any
33 credit computed under Part 10 (commencing with Section 17001)
34 for ~~pass-through~~ pass-through to shareholders in accordance with
35 the provisions of Section 1366 of the Internal Revenue Code.

36 (2) With respect to credits ~~which~~ that are allowed to the “S
37 corporation” only because it is treated in the same manner as an
38 individual, the provisions of Section 1366(a) of the Internal
39 Revenue Code shall be modified to provide that the shareholder’s

1 pro rata share of the corporation's credits shall include the credit
2 for political contributions allowed under Section 17053.14.

3 (b) Section 1366(f) of the Internal Revenue Code, relating to
4 special rules, ~~shall be~~ is modified as follows:

5 (1) The amount of tax used to compute the reduction allowed
6 by Section 1366(f)(2) ~~shall be~~ is the amount of tax imposed on
7 built-in gains under this part.

8 (2) The amount of tax used to compute the reduction allowed
9 by Section 1366(f)(3) ~~shall be~~ is the amount of tax imposed on
10 excess net passive income under this part.

11 (c) *The amendments to this section made by this act shall apply*
12 *to taxable years beginning on or after January 1, 2003.*

13 SEC. 2. Section 23806 of the Revenue and Taxation Code is
14 amended to read:

15 23806. (a) Section 1371(a) of the Internal Revenue Code,
16 relating to application of Subchapter C rules, is modified to
17 provide that, notwithstanding subdivisions (a) and (e) of Sections
18 17024.5 and 23051.5, any election by an "S corporation" or its
19 shareholders under Section 338 of the Internal Revenue Code,
20 relating to certain stock purchases treated as asset acquisitions, for
21 federal purposes ~~shall be~~ is treated as an election for purposes of
22 this part and a separate election under paragraph (3) of subdivision
23 (e) of Section 17024.5 or 23051.5 ~~shall not be~~ is not allowed.

24 (b) No election under Section 338 of the Internal Revenue
25 Code, relating to certain stock purchases treated as asset
26 acquisitions, ~~shall be~~ is allowed for state tax purposes unless the
27 "S corporation" or its shareholders made a valid election for
28 federal income tax purposes under Section 338 of the Internal
29 Revenue Code.

30 (c) (1) *Section 1371(b)(1) of the Internal Revenue Code is*
31 *modified to provide that any corporation described in paragraph*
32 *(2) is allowed to carry forward a net operating loss of the*
33 *corporation as a "C corporation," as allowed under this part,*
34 *from the last taxable year beginning before January 1, 2002, to the*
35 *first taxable year beginning on or after January 1, 2004, in which*
36 *the corporation is treated as an "S corporation" pursuant to the*
37 *enactment of Chapter 35 of the Statutes of 2002.*

38 (2) *This subdivision applies to a corporation that, for its last*
39 *taxable year beginning before January 1, 2002, was an "S*
40 *corporation" for federal income tax purposes and a "C*

1 corporation” for purposes of Part 10 (commencing with Section
2 17001), Part 10.2 (commencing with Section 18401), and this
3 part, and, as a result of the enactment of Chapter 35 of the Statutes
4 of 2002, is an “S corporation” for the corporation’s taxable year
5 beginning on or after January 1, 2004.

6 (d) Section 1371 (d) of the Internal Revenue Code ~~shall~~ does
7 not apply.

8 ~~(d) (1) Subdivisions (a) and (b) shall apply to any transaction~~
9 ~~occurring on or after January 1, 1998, in a taxable year beginning~~
10 ~~on or after January 1, 1997.~~

11 ~~(2) Subdivision (c) shall apply to taxable years beginning on or~~
12 ~~after January 1, 1997.~~

13 (e) The amendments to this section made by this act shall apply
14 to taxable years beginning on or after January 1, 2004.

15 SEC. 3. Section 23809 of the Revenue and Taxation Code is
16 amended to read:

17 23809. There is hereby imposed a tax on built-in gains
18 attributable to California sources, determined in accordance with
19 the provisions of Section 1374 of the Internal Revenue Code,
20 relating to tax imposed on certain built-in gains, as modified by
21 this section.

22 (a) (1) The rate of tax specified in Section 1374(b)(1) of the
23 Internal Revenue Code ~~shall be~~ is equal to the rate of tax imposed
24 under Section 23151 in lieu of the rate of tax specified in Section
25 11(b) of the Internal Revenue Code.

26 (2) In the case of an “S corporation” which is also a financial
27 corporation, the rate of tax specified in paragraph (1) shall be
28 increased by the excess of the rate imposed under Section 23183
29 over the rate imposed under Section 23151.

30 (b) ~~The provisions of Section 1374(b)(2) of the Internal~~
31 ~~Revenue Code, relating to net operating losses, is modified to~~
32 ~~provide that any net operating loss allowed or allowable under~~
33 ~~subdivision (c) of Section 23806 is not allowed as a deduction~~
34 ~~against net recognized built-in gain.~~

35 (c) Section 1374(b)(3) of the Internal Revenue Code, relating
36 to credits, shall be modified to provide that the tax imposed under
37 subdivision (a) shall not be reduced by any credits allowed under
38 this part.

39 ~~(e) The provisions of~~

1 (d) Section 1374(b)(4) of the Internal Revenue Code, relating
2 to coordination with Section 1201(a), ~~shall not be applicable~~ *does*
3 *not apply*.

4 ~~(d)–~~

5 (e) In the case of a corporation ~~which~~ *that* is subject to the
6 provisions of former Section 1374 of the Internal Revenue Code
7 (prior to amendment by Public Law 99-514), the provisions of that
8 section ~~shall be~~ *are* modified to provide that:

9 (1) The tax specified in Section 1374(b)(1) of the Internal
10 Revenue Code ~~shall be~~ *is* equal to the rate of tax imposed under
11 Section 23151 in lieu of the rate of tax specified in Section 11(b)
12 of the Internal Revenue Code.

13 (2) In the case of an “S corporation” ~~which~~ *that* is also a
14 financial corporation, the rate of tax specified in paragraph (1)
15 shall be increased by the excess of the rate imposed under Section
16 23183 over the rate imposed under Section 23151.

17 (f) *The amendments to this section made by this act shall apply*
18 *to taxable years beginning on or after January 1, 2004.*

19 ~~Code is amended to read:~~

20 ~~23801. (a) Except as otherwise provided, a corporation that~~
21 ~~has in effect for federal purposes a valid election under Section~~
22 ~~1362(a) of the Internal Revenue Code is an “S” corporation for~~
23 ~~purposes of Part 10 (commencing with Section 17001), Part 10.2~~
24 ~~(commencing with Section 18401), and this part.~~

25 ~~(b) A corporation that is an “S corporation” for federal income~~
26 ~~tax purposes, is an “S corporation” for purposes of Part 10~~
27 ~~(commencing with Section 17001), Part 10.2 (commencing with~~
28 ~~Section 18401), and this part, and its shareholders are shareholders~~
29 ~~of an “S corporation” without regard to whether the corporation~~
30 ~~is qualified to do business or is incorporated in this state.~~

31 ~~(c) Notwithstanding subdivision (a), a corporation that elects~~
32 ~~“S corporation” status under Section 1362 of the Internal Revenue~~
33 ~~Code for federal income tax purposes, but which is not qualified~~
34 ~~to be an “S corporation” under subdivision (a) of Section 23800.5,~~
35 ~~is not an “S corporation” for purposes of Part 10 (commencing~~
36 ~~with Section 17001), Part 10.2 (commencing with Section 18401,~~
37 ~~and this part.~~

38 ~~(d) Except as provided in subdivision (c), a corporation that is~~
39 ~~an “S corporation” for purposes of this part is not included in a~~

1 combined report pursuant to Chapter 17 (commencing with
2 Section 25101).

3 (e) (1) In cases where the Franchise Tax Board determines that
4 the reported income or loss of a group of commonly owned or
5 controlled corporations (within the meaning of Section 25105),
6 which includes one or more corporations treated as an “S
7 corporation” under Chapter 4.5 (commencing with Section
8 23800), does not clearly reflect income (or loss) of a member of
9 that group or represents an evasion of tax by one or more members
10 of that group, and the Franchise Tax Board determines that the
11 comparable uncontrolled price method prescribed by regulations
12 pursuant to Section 482 of the Internal Revenue Code cannot
13 practically be applied, the Franchise Tax Board may, in lieu of
14 other methods prescribed by regulations pursuant to Section 482
15 of the Internal Revenue Code, apply methods of unitary
16 combination, pursuant to Article 1 (commencing with Section
17 25101) of Chapter 17, to properly reflect the income or loss of the
18 members of the group.

19 (2) The application of the provisions of this subdivision does
20 not affect the treatment of any corporation as an “S corporation.”

21 (f) The tax for a “C corporation” for a short year is determined
22 in accordance with Chapter 13 (commencing with Section 24631);
23 in lieu of Section 1362(e)(5) of the Internal Revenue Code.

24 (g) (1) A termination of a federal election pursuant to Section
25 1362(d) of the Internal Revenue Code, that is not an inadvertent
26 termination pursuant to Section 1362(f) of the Internal Revenue
27 Code, shall simultaneously terminate the “S corporation” election
28 for purposes of Part 10 (commencing with Section 17001), Part
29 10.2 (commencing with Section 18401), and this part.

30 (2) A federal termination by revocation is effective for
31 purposes of this part and shall be reported to the Franchise Tax
32 Board in the form and manner prescribed by the Franchise Tax
33 Board no later than the last date allowed for filing federal
34 termination for that year under Section 1362(d) of the Internal
35 Revenue Code.

36 (h) (1) The provisions of Section 1362(b)(5) of the Internal
37 Revenue Code, relating to authority to treat late elections, etc., as
38 timely, apply only for taxable years beginning on or after January
39 1, 1997, with respect to elections under Section 1362(a) of the

~~1 Internal Revenue Code for taxable years beginning on or after
2 January 1, 1997.~~

~~3 (2) Notwithstanding the provisions of paragraph (1), if for any
4 taxable year beginning on or after January 1, 1987, a corporation
5 fails to qualify as an "S corporation" for federal income tax
6 purposes solely because the federal Form 2553 (Election by a
7 Small Business Corporation) was not filed timely, the corporation
8 shall be treated for purposes of this part as an "S corporation" for
9 the taxable year the "S corporation" election should have been
10 made, and for each subsequent year until terminated, if both of the
11 following conditions are met:~~

~~12 (A) The corporation and all of its shareholders reported their
13 income for California tax purposes on original returns consistent
14 with "S corporation" status for the year the "S corporation"
15 election should have been made, and for each subsequent taxable
16 year (if any) until terminated.~~

~~17 (B) The corporation and its shareholders have filed with the
18 Internal Revenue Service a federal Form 2553 requesting
19 automatic relief with respect to the late "S corporation" election,
20 in full compliance with the federal Revenue Procedure 1997-48,
21 I.R.B. 1997-43, and have received notification of the acceptance
22 of the untimely filed "S corporation" election from the Internal
23 Revenue Service. A copy of the notification shall be provided to
24 the Franchise Tax Board upon request.~~

~~25 (i) The provisions of Section 1362(f) of the Internal Revenue
26 Code, relating to inadvertent invalid elections or terminations,
27 apply only for taxable years beginning on or after January 1, 1997,
28 with respect to elections under Section 1362(a) of the Internal
29 Revenue Code for taxable years beginning on or after January 1,
30 1997.~~